A REVIEW OF DEVELOPMENTS IN COMPETITION POLICY

Carolynne James and Scott Davenport

NSW Agriculture
Orange, NSW

Contributed paper to the 39th Annual Conference of the
Australian Agricultural Economics Society
University of Western Australia
February 14–16, 1995

Abstract

The Report into National Competition Policy released in August 1993 provided the basis for regulatory reforms that will be implemented in the near future. Since then, however, significant changes have been proposed that appear likely to reduce the level of efficiency gains achieved. These developments in competition policy and their impact are discussed in this paper.

1 The views expressed in the paper are those of the authors and are not necessarily those of NSW Agriculture or the NSW Government.
CONTENTS

1. INTRODUCTION

2. HILMER RECOMMENDATIONS

3. EFFECTS ON AGRICULTURE OF HILMER RECOMMENDATIONS

4. DEVELOPMENTS SINCE THE HILMER REPORT
   4.1 COAG Negotiations
   4.2 Public Choice Theory and Policy Development
   4.3 The Draft Legislative Package
   4.4 Inter-governmental Agreements

5. DEFICIENCIES OF COMPETITION POLICY
   5.1 Universal Application
   5.2 Public Benefit Test
   5.3 Scope of Competition Policy

6. CONCLUSION

REFERENCES
1. INTRODUCTION

The Hilmer Report on competition policy was released in August 1993 and a National Competition Policy is scheduled for introduction in July 1995. The purpose of this paper is to highlight the further developments in competition policy since the release of the Hilmer Report and to discuss aspects of the legislation that may reduce the level of economic efficiency gains achieved.

This paper is in three parts. First, the Hilmer recommendations are reviewed. Second, developments in competition policy are reviewed from the release of the Hilmer report, through the COAG negotiation process to derive the proposals that stand today. Thirdly, previously identified deficiencies in the Hilmer competition policy proposals are discussed along with the extent to which the more recent developments are likely to overcome these problems.

2. HILMER RECOMMENDATIONS

The Hilmer Committee endeavoured to underpin their recommendations with a consistent and rigorous perspective of competition policy. Competition policy was defined as:

- encompassing all policy dealing with the extent and nature of competition in the economy and as such, was considered to be much wider than the anti-competitive behaviour provisions in Part IV of the Commonwealth Trade Practices Act (TP Act);

- aiming to foster the competitive process rather than competition for it's own sake—"...it (competition policy) seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with social objectives." (National Competition Policy 1993).

These definitions encompass both the regulatory and structural elements of competition policy. Structural reform of markets involves reducing barriers to entry, removing inappropriate regulation and exposing publicly owned bodies to competitive market forces – activities often associated with the Industry Commission. Regulatory measures aim to address cases of market failure through anti-competitive conduct provisions.

Hilmer defined the following six key elements of a National Competition Policy.

- Limiting anti-competitive conduct of firms.
- Reforming regulation which unjustifiably restricts competition.
- Reforming the structure of public monopolies to facilitate competition.
- Providing third-party access to certain facilities that are essential for competition.
- Restraining monopoly pricing behaviour.
- Fostering "competitive neutrality" between government and private businesses when they compete.
The following three organisations were recommended to administer the new arrangements:

- The National Competition Council (NCC) to advise the Australian Government on competition policy issues. Continuation of the Council beyond five years would be subject to review.

- The Australian Competition Commission (ACC) be established as the organisation to administer competition policy, replacing the current Trade Practices Commission (TPC) and Prices Surveillance Authority.

- The current Trade Practices Tribunal would continue to consider appeals on authorisation decisions of the ACC and be renamed the Australian Competition Tribunal (ACT).

3. EFFECTS ON AGRICULTURE OF HILMER RECOMMENDATIONS

The changes recommended by Hilmer have the potential to directly impact on agricultural marketing arrangements. These include changes to exemptions from the TP Act, and more rigorous regulatory review procedures, and allowances for recommended pricing arrangements.

- Section 51(1) of Part IV of the TP Act contains exemption provisions for certain anti-competitive activities by virtue of their establishment under state or territory statute or regulation. Hilmer recommended that these exemptions be removed and that Section 51(1) be revoked. The Hilmer Committee argued that Section 51 resulted in inefficiencies that outweigh the potential benefits of the exemption. The Committee was concerned that the effect of the exemption was to serve sectional and regional interests at the expense of national interests. They also argued that the State focus of the exemption process reduced the scrutiny of particular proposals of national significance.

It was stated, for example, that these exemptions:

...have the effect of fragmenting the coverage of competitive conduct rules and are thus not consistent with the goals of developing an open, integrated domestic market for goods and services; the increasingly national operations of markets; reducing complexity; or eliminating administrative duplication...(National Competition Policy 1993).

- Despite the changes to Section 51(1), there remains activities of statutory marketing boards, such as vesting and licensing, which have anti-competitive effects but are not captured by the Act. This is because they are not considered to constitute 'competitive activity' between buyers and sellers.

In order to address anti-competitive activities that lie outside the jurisdiction of the TP Act, the Hilmer Committee recommended a process of public review. The Committee recognised that a co-operative national review process would avoid the inefficiencies of "bandwagon" or simultaneous reviews across States on the same issue. The Commission was of the view that over time, entrenched regulation captures a constituency of interests providing an ongoing source of economic rents to particular groups. The Hilmer Committee argued that a national perspective would allow the magnitude of protected interests to be placed in perspective.
In light of these concerns Hilmer recommended that all Australian governments adopt a set of principles aimed at ensuring that statutes and regulation do not restrict competition unless the restriction is justified in the 'public interest'. Hence, it was envisaged that the activities of SMA's would be subject to a public benefit test within five years and every five years thereafter. It was proposed that new activities undergo a public benefit test and a subsequent five year review. It was recommended that the test be conducted at State level with NCC involvement where the issue was considered of 'national interest'.

Under the current TP Act price fixing for goods is prohibited outright, whilst price fixing for services and recommended pricing for goods and services can be exempted. The Hilmer Committee argued for the removal of these exemptions so that treatment of goods and services is consistent.

The Committee argued that recommended pricing often had the same effect as price fixing and could be used to 'cloak' price fixing arrangements. They recommended that the exemption for price recommendations by groups of competitors numbered more than 50 be repealed, although they recommended that authorisation be retained. Arguments by agricultural producers that recommended prices were needed because processors exploit producers was rejected by the Committee. It was considered that removal of the exemption per se would not make price recommendations illegal or stop information sharing arrangements, however, it would make the anti-competitive impacts of price recommendations transparent and industries accountable for authorisation.

4. DEVELOPMENTS SINCE THE HILMER REPORT

4.1 COAG Negotiations

In February 1994, at the Council of Australian Governments (COAG)\(^2\) meeting, State and Commonwealth Governments subsequently endorsed the principles of the Hilmer report and initiated an implementation process.

On entering negotiations, State Governments were reticent to embrace competition reform, arguing that gains from competition would be compromised by the loss of monopoly rents from public utilities. Hence, the majority of gains from economic growth would be secured by the Commonwealth, at the expense of the States. Two options emerged to coerce State co-operation in competition reforms:

- provide compensation to the States for losses associated with increased competition of government enterprises; or
- reform State/Commonwealth financial arrangements, specifically taxation, to enable the States to directly capture gains from increased competition.

\(^2\) The COAG Council comprises of the Prime Minister, Premiers and Chief Ministers and the President of the Local Government Association. Since its inaugural meeting in 1992 its function has been to co-ordinate policy across all ministerial councils on issues of national significance (Hede 1993).
The Prime Minister clearly stated that State/Commonwealth tax reform would not take place, arguing that the Commonwealth's monopoly on income tax was the "glue which held the Federation together" (SMH 24/2/94). Compensation was therefore promoted, and as specified in the February COAG statement, where the Council agreed to the following:

1. any recommendation from the Report being applicable to all bodies, State and Commonwealth agencies and authorities;

2. that the ACC be established;

3. work on new legislation and a review of implementation procedures be ready for consideration at the next COAG meeting in August 1994;

4. the Commonwealth consider assistance to the States and Territories for loss of monopoly rents and the process for managing adjustment; and,

5. it was recognised that the changes required by reforms would involve changes to State and Territory regulatory arrangements and the possibility of extending the two year transition period recommended by Hilmer should be considered.

Two Commonwealth/State Committees were formed - a Legislative Committee and an Audit Committee. The former to oversee the drafting of relevant legislation, the latter to examine specific industry impacts of the recommendations. These groups were to report at the August COAG meeting in Darwin.

State Government Departments conducted "audits" identifying legislation and services that may be affected by the recommendations. For agricultural agencies, regulated marketing was highlighted as a concern. It was not immediately apparent, however, which activities of statutory marketing authorities were 'voluntary' and therefore subject to the TP Act, and which were 'involuntary' or mandated by statute and therefore exempt from the TP Act. The involuntary activities would be subject to the legislative review provisions of the competition principles agreement. Considerable concerns were raised that removal of the Section 51 exemption would leave States without the means to exempt certain activities.

Following the February meeting the States, notably NSW and Queensland, maintained pressure on the Commonwealth to acknowledge their concerns. The Hilmer Report had not fully addressed the impact of the recommendations on government ownership and associated revenue streams. In a brief discussion (p. 355), the report acknowledged that reduced revenue sources may impede the State's capacity to implement reform, but concluded that budget impacts would not involve more than negligible revenue transfers between levels of government. The Commission argued that few State government monopolies were making commercial returns let alone monopoly profits, hence improving efficiency through competition would not necessarily reduce returns.
In July, prior to the August COAG meeting, a package aimed at restructuring State/Commonwealth relations and reducing administrative duplication was proposed by the Commonwealth government. States were offered more discretion in the spending of Commonwealth grants and greater control over some jointly administered programs. In particular, the Commonwealth agreed to reassess its emphasis on tied grants, which gives the Commonwealth a major 'say' in how the States deliver services such as health, education and social welfare.

The package was also designed to form the basis of the Commonwealth's strategy for the August 1994 COAG meeting on the implementation of the national competition reform agenda. Extra spending control for the States represented a clear concession by the Commonwealth Government. During this period, State resistance to reforms was criticised by business and consumer groups.

The August COAG meeting in Darwin was dominated by State claims for compensation. They calculated that reforms flowing from implementation would result in a $24 billion increase in GDP and a $5 billion increase in Commonwealth tax revenue (AFR 11/11/94). In the face of these estimates, the Commonwealth Governments' compensation offer of $750 million was rejected. This stalemate was reflected in the subsequent "in principle" agreement issued by COAG, that all governments should share the benefits from the Hilmer reforms. In a conciliatory move the Commonwealth Government proposed that the Industry Commission undertake an assessment of the benefits to assist the Council reach a conclusive outcome at the February 1995 COAG meeting.

The compensation concession by the Commonwealth Government may be interpreted as a 'win' by the States, but also a potential loss to efficient reform. An efficient implementation on competition policy would see increased tax revenue being redistributed to States as the appropriate reward.

4.2 Public Choice Theory and Policy Development

Public choice theory has frequently been adopted to explain the evolution of sectoral policy particularly in the United States and more recently in Australian and New Zealand (Sieper 1982, Martin 1990, Scrimgeour and Pascor 1994). Public choice theory can be defined as the economic study of non-market decision making in the government realm, or as the application of economics to political science (Johnson 1994). A simple illustration of public choice theory is to consider a policy as the product, the bureaucracy, politicians, voters and interest groups as the market participants and votes, budget allocations and control of the policy agenda as the currency of exchange.

In relation to the development of competition policy, public choice theory can be used to explain the interplay between State and Commonwealth Governments. An important issue is the retention of State power through legislative mandate and exemption arrangements, or more correctly, the ability of State Governments to differentiate themselves and thereby appeal to the voting public. If the States have no revenue raising power, for example, and are increasingly funded through tied Commonwealth grants, their 'nature' and 'political appeal' is essentially determined by the Commonwealth. This may appeal to 'centralists', however, others may argue that a degree of State autonomy is healthy for the democratic process.

Similarly the Commonwealth can be viewed as seeking to accumulate greater power by undermining the revenue base of the States and playing a greater role in how revenue is spent. This power is of course critically linked to the adequacy of Commonwealth-State financial arrangements.
4.3 The Draft Legislation Package

A draft package of legislation and inter-governmental agreements prepared by the Legislative Committee was tabled at the August COAG. The package contained three elements:

(i) The Competitive Conduct Rules which included amendments to the TP Act and complementary State application laws;

(ii) The Conduct Code Agreement; and

(iii) The Competition Principles Agreement.

The Conduct Code Agreement relates to the application of the Competitive Conduct Rules by the States and Territories, and defines appointment procedures for the National Competition Commission. The Competition Principles Agreement formalises the States’ commitment to competition principles not contained in the Competitive Conduct Rules.

The legislative package contained three key changes to the original Hilmer proposals:

i) the Section 51 exemption mechanism was not removed,

ii) recommended pricing for goods exemption was retained

iii) the power of the NCC to intervene in State authorisations was altered such that NCC involvement was at the discretion of the relevant State.

These changes represent the latest developments in competition policy and have the potential to limit the realisation of efficiency gains. Retaining Section 51, for example, allows each State the capacity to implement differential regulatory regimes, directed towards sectoral objectives, which may have anti-competitive effects.

Hilmer’s recommendation that the onus for determining whether particular arrangements were of national importance rest with the NCC, not only would have facilitated a consistent approach to government intervention, but would also have ensured consistency in State and Commonwealth assessments of public benefit. It could therefore be argued that the draft package undermines the 'national' focus of competition policy.
Table 1 - Summary of key changes in competition policy since Hilmer

<table>
<thead>
<tr>
<th>Original Reforms</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 51 exemption to be removed and no future exemptions permitted.</td>
<td>Section 51 exemption to be retained with some changes and those exemptions which already comply with the new limitations will continue to be effective.</td>
</tr>
<tr>
<td>Recommended pricing prohibited outright.</td>
<td>Recommended pricing exemption retained</td>
</tr>
<tr>
<td>NCC to lead investigations into State public benefit assessments of national significance as appropriate.</td>
<td>NCC involvement in State public benefit assessments is at the States' discretion.</td>
</tr>
</tbody>
</table>

4.4 Inter-governmental Agreements

The draft competition legislative package includes two Inter-governmental Agreements: The Conduct Code Agreement and the Competition Principles Agreement. State/Commonwealth "agreements" are a relatively new instrument in inter-governmental relations. The Inter-governmental Agreement on the Environment is one of the few examples. The enforceability of these agreements is yet to be tested and is seen as a key issue in the effectiveness of the competition package. Without meaningful accountability requirements State governments may be encouraged to foster sectional interests over Agreement obligations.

The penalty for breach of the agreement is exclusion from the agreement itself and exclusion from protection against TP Act prosecution during the transitional period. After competition reforms are introduced, State laws will not be effective in granting TP Act immunity unless the state is a "fully participating party" to the Inter-governmental Competition Principles Agreement.

The Conduct Code Agreement

Under this Agreement all parties are obliged to notify the Commission of legislation they have enacted which relies upon subsection 51(1) of the TPA. The conduct code is responsible for the TP Act being extended to all unincorporated entities. This includes co-operatives, partnerships, sole traders and trusts that are outside the scope of the existing Act such entities are a common feature of the agricultural sector.

---

3 The Intergovernmental Agreement underpinning Mutual Recognition Legislation involved specific changes to State and Commonwealth legislation.
The Competition Principles Agreement

The Competition Principles Agreement formalises the States' commitment to those competition principles not contained in the Competitive Conduct Rules. As such, it embraces the four areas of competition policy that were identified by Hilmer as additional to the TP Act. These four areas are:

- Legislation Review
- Prices Oversight of Government Trading Enterprises
- Competitive Neutrality Policy

Legislation Review

An issue significant to agricultural industries is the provisions for review of legislation that restricts competition. Broadly, these provisions include a public review process, based on a public benefit test, with an initial review by the year 2000 and regular subsequent reviews at intervals of 5 years and with extensions of no more than 10 years.

The following five step process was suggested for legislation reviews:

a) Clarify the objectives of the legislation.
b) Identify the nature of the restriction on competition.
c) Analyse the likely effect of the restriction on competition and on the economy generally.
d) Assess and balance the costs and benefits of the restriction.
e) Consider alternative means for achieving the same result including non legislative approaches.

This process encapsulates the public benefit test principle and aims to provide greater transparency of the basis of government intervention.

Prices Oversight of Government Trading Enterprises and Competitive Neutrality Policy

An improved prices oversight mechanism and the achievement of competitive neutrality by government agencies and trading enterprises avoids problems of 'crowding-out' by government and enhances productivity and service delivery. This will also have the effect of agencies distinguishing CSO's from commercial service provision, leading to greater transparency and accountability in this area.

The establishment of appropriate price levels for government services will require closer examination of what constitutes 'public' and 'private' goods. For agricultural agencies the bulk of research and development services are likely to be of a private nature, however public benefits from these activities in the form of 'spillovers', may provide a basis for price discounting.
5. DEFICIENCIES OF COMPETITION POLICY

5.1 Universal Application of the TP Act

While a national approach to competition policy is desirable, the adequacy of policy measures such as the TP Act in addressing market failure requires close scrutiny if government failure is to be minimised. The TP Act is accompanied by sufficient anomalies to indicate that an element of government failure is an associated feature (Pengilly 1993). A key issue in relation to a national competition policy, is therefore the extent to which efficiency losses associated with poorly specified 'competition rules' might be magnified with the more widespread application of the Act (Davenport et al 1994).

The potential for government failure in the application of the TP Act underpins the view put forward by the Industry Commission (Industry Commission 1993) that increased attention be given to monopoly access and pricing and to the strategic applications of the TP Act to particular markets. An important argument put forward by the Commission was that the internationalisation of markets in the 1990's, reinforced by tariff reductions, will have the effect of highlighting the shortcomings of process based, domestically orientated competition regulation based on narrow definitions of markets and competition. The point being that markets are not defined by state or national boundaries.

The post Hilmer negotiations and the development of inter-governmental agreements have extended the reach of the TP Act and principles. There appears to have been little attention given to the strategic application of the Act or the possible amendment of provisions within the Act to accommodate more dynamic interpretations of 'markets' and 'competition'.

5.2 Public Benefit Tests

There continues to be uncertainty regarding the nature and application of public benefit tests. The TPC and consequently the Hilmer Committee did not attempt to prescribe estimation techniques for public benefit assessment. Instead, TPC rulings were cited as examples of assessment rationale. It is notable, however, that these assessments have in most cases been 'partial' and based on rationales including income stability and price stabilisation.

In the absence of a prescribed and rigorous public benefit test, State and Commonwealth governments have the opportunity to compromise anti-competitive arrangements leading to continuation of sectorally based policies at the expense of the national interest. This is clearly an area where economists can play an important role to ensure partial and general equilibrium methodologies are applied, as appropriate.

5.3 Scope of Competition Policy

Various government policies and subsidies provided by way of rural taxation concessions and adjustment assistance provide benefits to particular market participants and therefore have the potential to impede competition and reduce economic efficiency. As mechanisms to redistribute income, they provide preferential treatment to market participants and hence impede competitive behaviour. Hilmer's "Reforming Regulatory Restrictions on Competition" section focuses on competitive
regulation directed at the interaction of market participants and hence other regulations that affect resource allocation are not captured. This issue has not been developed through the COAG process either. Incorporation of such policies into the competition review agenda would reduce the likelihood of governments intervening in markets on grounds other than market failure.

6. CONCLUSIONS

Recent amendments to the Hilmer recommendations appear likely to reduce the level of efficiency gains generated by competition policy. Specifically the retention of Section 51 of the TPA will reduce the consistency with which competition policy is applied across State and Commonwealth jurisdictions. This lack of consistency will be facilitated by public benefit tests, variable in nature and rigour.

Two concerns identified in relation to the scope of competition policy that may lessen the efficiency gains attainable include:

- the on-going difficulties associated with the inability of provisions within the TP Act to fully reflect the dynamics of markets and competition; and
- some forms of government intervention not judged to be directly influencing the conduct of market participants but which impedes competition by favouring particular groups such as taxation concessions and adjustment assistance within agriculture, are not incorporated within competition policy.

Further issues relating to the effective implementation of reforms will be:

- the States compliance with intergovernmental agreements; and
- the nature of State/Federal financial relationships which may impede the implementation of the policy because of disputes over revenue distribution.
REFERENCES


Industry Commission (1993), Institutional Arrangements for the Regulation of Natural and Mandated Monopolies, supplementary submission to the National Competition Policy Review.


National Competition Policy (1993), Report by the Independent Committee of Inquiry, AGPS, Canberra.


Sieper, E. (1982), Rationalising Rustic Regulation. Center for Independent Studies, St Leonards, NSW.

SMA (1994), Sydney Morning Herald.